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Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25; July 1, 2005 Annual Access Charge Tariff Filing, WCB/Pricing 05-22

Dear Ms. Dortch:

The Commission should deny the requests by eTUG¹ to impose an interim 5.3 percent special access productivity factor and by ATX *et al.*² to re-set rates in Phase II areas to “price cap” levels, prohibit further rate increases, and afford special access customers a “fresh look” enabling them to abrogate their contracts with price cap LECs. The Commission’s progressive deregulation of special access services over time has been a regulatory and marketplace success story. As

¹ Letter from Brian R. Moir, counsel to the eCommerce & Telecommunications User Group (individual members are not identified), and C. Douglas Jarrett, counsel to the Telecommunications Committee of the American Petroleum Institute, to Marlene H. Dortch, Secretary, Federal Communications Commission, dated May 10, 2005 (“eTUG/API Letter”).

² Letter from Richard M. Rindler, Swidler Berlin, to Marlene H. Dortch, Secretary, Federal Communications Commission, dated May 27, 2005 (“ATX *et al.* Letter”). On May 13, CompTel/ALTS filed a brief letter in support which merely echoes eTUG/API’s argument, without adding any additional substantive points. *See* letter from Michael H. Pryor, counsel for CompTel/ALTS, to Marlene H. Dortch, Secretary, Federal Communications Commission, dated May 13, 2005 (“CompTel/ALTS letter”). CompTel/ALTS does at least recognize that the Commission could not adopt an interim X factor without first soliciting public comment. CompTel/ALTS letter at 3. Global Crossing subsequently did the same, *see* letter from Paul Koroupas, Vice President and Senior Counsel, Global Crossing, to Marlene H. Dortch, Secretary, Federal Communications Commission, dated May 24, 2005 (“Global Crossing letter”), as did T-Mobile. *See* letter from

anticipated by the Commission in the *Pricing Flexibility Order*, competition has grown rapidly and prices have dropped.³ Accordingly, there is no basis for imposing arbitrary and severe limits on those rates without even waiting to evaluate the record to be compiled in this proceeding.

The first special access competitors began offering service shortly after divestiture, and the provision of special access services has long been competitive. This competition has greatly benefited customers, who have enjoyed not just a multitude of service options, but steadily declining prices. Indeed, since pricing flexibility was initiated in 2001, Verizon's average revenue per special access line has decreased by approximately *15 percent per year*, a greater average decline than occurred in the preceding five years under pure price cap regulation. In fact, this decline is significantly greater than the change in the "price cap index," which has declined by 3.9 percent per year since 2001, providing conclusive evidence that special access rates are disciplined by the market.

The same story holds true for DS1 and DS3 services individually. For the past three years, Verizon's average revenue per DS1 line has declined by 4.2 percent per year, and its average revenue per DS3 line has dropped by 6.1 percent per year. Once again, these decreases exceeded the change in the price cap index. Even more impressive, these declining prices took place against the backdrop of significantly increasing demand: while special access lines increased by approximately 15 percent per year from 2001 through 2004, special access revenues grew by only 4.8 percent annually.

These rate reductions benefit all special access customers, large and small. As a result of competitive pressure, Verizon offers a wide range of pricing plans containing discounts of up to 40 percent off standard, month-to-month special access rates, supplemented by contract tariffs (in pricing flexibility areas) offering even greater discounts. Currently, approximately 85 percent of Verizon's special access demand is served through these pricing plans rather than month-to-month rates. Because many of these plans provide discounts for term rather than volume commitments, substantial savings are available even if a customer takes just one DS1 circuit from Verizon at a single location. In fact, Verizon offers dozens of plans that do not require the customer to commit any particular volume of services to Verizon in order to receive a discount – and the few Verizon plans with volume commitments do not contain greater discounts than the non-volume dependent term plans (although they do afford customers greater flexibility to move and discontinue circuits as they build out their networks to additional locations).

To be sure, customers would always prefer to pay even lower rates than they already do, and the users of special access services are obviously highly sophisticated businesses that will use every available leverage point to obtain them, including regulatory proceedings such as the present

³ Detailed support for the factual points included in this letter will be provided in Verizon's comments in this docket, to be filed on June 13.

one. But there simply is no justification for regulatory involvement in a functioning competitive segment of the market.

Indeed, intense competitive pressure compels Verizon to offer these discounts. Verizon's carrier customers – which account for 80 percent of Verizon's special access demand – regularly inform Verizon that they will take their business elsewhere if Verizon does not offer substantial discounts, and Verizon has responded to these market pressures through creative contract tariff arrangements, which are used to serve both small and large carriers as well as enterprise customers. Moreover, Verizon's carrier-customers have demonstrated that they can use Verizon's special access services, in combination with their own networks and facilities obtained from third parties, to compete effectively in providing high-capacity retail services to enterprise customers. Likewise, end user customers purchasing special access from Verizon – which account for roughly 20 percent of Verizon's special access revenues – are sophisticated purchasers who are not shy about demanding reduced rates, and Verizon has accommodated those requests in approximately one dozen contract tariffs.

The impressive extent of special access competition is not surprising, because special access services are tailor-made for competitive entry. Special access demand is highly concentrated, with more than 80 percent of demand generated in roughly 8 percent of Verizon's wire centers. This enables competitors to address a large portion of demand through targeted investments, and they have done exactly that.

In Verizon's top 40 MSAs, there are now fiber-based collocators in *two-thirds* of the central offices accounting for 80 percent of demand for high-capacity special access services. And, as impressive as that statistic is, it does not even begin to show the true extent of competition. Data compiled by independent analysts reveal that there are often many more competitive networks than there are collocators, because competing providers of high-capacity services often have no need to collocate in Verizon central offices. Moreover, these data show that competitive fiber reaches directly to anywhere from several hundred to almost two thousand buildings in many of these MSAs. On top of all this, there is an active special access resale market, with companies such as XO, Time Warner Telecom, Looking Glass Networks, AT&T, FiberNet, Neon, AboveNet, Xspedius, and many others offering capacity on their networks to third parties. Still further competition comes from fixed wireless providers – whose services already were used by 40 percent of large businesses, 29 percent of middle-sized businesses, and 23 percent of small businesses at the end of 2003 – and from cable companies – which have deployed fiber to thousands of commercial buildings in Verizon's region and have rapidly become major players in the supply of both wholesale and retail high-capacity services.

Against this background, there is simply no justification for imposing an arbitrary 5.3 percent interim special access X factor prior to the July 1 filing date for the 2005 annual access tariffs. Nor is there any basis for the even more onerous measures urged by some parties, such as re-setting rates in Phase II areas to “price cap levels,” prohibiting additional rate increases in those

areas, and affording special access customers a “fresh look” enabling them to abrogate their contracts with price cap LECs.

First, there is no basis for the claim that intrusive new regulatory measures are needed, and imposing them in the competitive special access business would be affirmatively harmful to competition because it would deter investment by all providers, including incumbent LECs, competitive LECs, and inter-modal competitors such as cable and fixed wireless companies.

The only reason that eTUG, API, and ATX *et al.* give for their requested relief is their belief that special access rates are excessive.⁴ But Verizon’s experience, as noted above, shows that special access prices are intensely competitive and have declined. The *sole support* these competitors offer for their position is the tired refrain that ARMIS reports show high rates of return for special access and BOCs have increased certain special access rates in Phase II areas. These assertions have gained no merit by dint of sheer repetition. The Commission has long recognized that the ARMIS rate of return data “do not serve a ratemaking purpose,” *Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd 2637, ¶ 194 (1991), and has emphasized that “reducing our regulatory reliance on earnings calculations based on accounting data is essential to the transition to a competitive marketplace.” *Price Cap Review for Local Exchange Carriers*, 12 FCC Rcd 16642, ¶ 150 (1997). There is good reason for this: the ARMIS data are so tainted by arbitrary cost allocations and mismatched revenues and expenses that they cannot be used to draw any inferences about market power.

Likewise, increases in certain special access rates in Phase II areas were anticipated in the *Pricing Flexibility Order* (as ATX *et al.* acknowledge) and, in any event, the rates bearing those increases – predominantly month-to-month prices – are essentially irrelevant because the vast majority of demand is satisfied pursuant to steeply discounted term and/or volume pricing plans. Moreover, the reality is that one would expect to see month to month rates increase as the market becomes more competitive. With less competition, there is less risk that a customer will go elsewhere after a short period and leave behind stranded investment. With more competition, the risk that the customer will go elsewhere is greater, and the need to recover more of the cost up front on short-term plans means prices for those plans will be higher.

Second, eTUG/API are wrong in asserting that the use of a special access X factor equal to GDP-PI will enable price cap LECs to avoid reducing special access rates.⁵ As explained above,

⁴ eTUG and API claim that interim relief is needed because “the X-Factor for special access services in the upcoming 2005 annual filing on July 1, 2005, will be equal to GDP-PI – *i.e.*, the Price Cap rules will not require the LECs to reduce their special access rates from current excessive levels.” eTUG/API Letter at 2.

⁵ CompTel/ALTS and Global Crossing make the same mistaken argument. *See* CompTel/ALTS letter at 2 (asserting that special access rates “will effectively remain frozen”), Global Crossing letter at 2 (same).

special access rates that customers actually pay have declined faster under pricing flexibility (and with an X factor equal to GDP-PI) than they did prior to 2001 (when a greater X factor was in effect). Moreover, even if that same pattern were not continued going forward, special access rates still will decline in real terms because price cap LECs cannot raise those rates to account for inflation. Accordingly, even though the price cap index itself is effectively frozen, rates will go down in economic terms. Put another way, a dollar will buy more special access in 2005 than it did in 2004, and still more in 2006 than in 2005, even if nominal rates remain constant.

Third, eTUG/API also are incorrect in claiming that the Commission never intended the special access X factor to remain equal to GDP-PI after the CALLS plan expired. To the contrary, as the Commission's rules make clear, the Commission contemplated that X would remain equal to GDP-PI beyond the CALLS plan: "*Starting* in the 2004 annual filing, X shall be equal to GDP-PI for the special access basket." 47 C.F.R. § 61.45(b)(1)(iv) (emphasis added). Moreover, the *CALLS Order* made clear the Commission's intent to consider further *deregulation* of special access rates, not to impose more intrusive regulation such as higher X factors: "as the term of the CALLS Proposal nears its end, we envision that the Commission will conduct a proceeding to determine whether and to what degree it can deregulate price cap LECs to reflect the existence of competition." *Access Charge Reform*, 15 FCC Rcd 12962, ¶ 36 (2000).⁶

Fourth, granting the relief sought by the competitors would be inconsistent with the Act because it would amount to a rate prescription, which the Commission may not undertake unless it first finds existing rates to be unlawful. The Commission's "authority to prescribe rate reductions under Section 205(a) depends upon a finding that current rates are or will be unreasonable." *LEC Price Cap Order*, ¶ 53. Moreover, any such finding may only occur *after* "full opportunity for public hearing," 47 U.S.C. § 205 – not before even receiving evidence. And in any event, there is no basis upon which the Commission possibly could make such a finding, given that special access rates are declining even as demand increases, and wholesale customers of the BOCs' special

⁶ Even if (1) there was a compelling need to grant some form of interim relief, and (2) the Commission had legal authority to take such extraordinary action – neither of which is the case – the Commission could not reasonably impose a 5.3% X factor in any event. Although that number was judicially upheld in 1996, it was based on a record compiled more than ten years ago. There is no record evidence upon which the Commission could conclude that, today, incumbent LECs enjoy productivity levels significantly greater than the economy as a whole. eTUG/API's alternative suggestion – to delay the annual filing date until an interim X factor is adopted – is not only unnecessary for the reasons discussed above, but impractical and highly disruptive in any event. The annual filing affects much more than just special access services. In addition, delaying the 2005 filing would affect more than this year's filing; it would create a need to adjust the PCI for the amount of time it will be in effect during this year's annual filing. The PCI also would have to be adjusted at the next annual filing in order to re-set it to an annual basis. Moreover, the Tariff Review Plan (TRP) format also would have to be modified, and the Commission would need to re-issue the new TRP format.

access services are using those services to compete quite effectively against the BOCs in the provision of downstream services to enterprise customers.

Fifth, in addition to the lack of any factual or policy basis for granting any form of interim rate reduction, granting the competitors' requests would violate the public notice and comment requirements of the Administrative Procedures Act ("APA"), *see* 5 U.S.C. § 553(b), (c).⁷ The Commission may override these bedrock APA obligations only for "good cause," an exception that is "narrowly construed and only reluctantly countenanced." *Utility Solid Waste Activities Group, et al v. EPA*, 236 F.3d 749, 754 (D.C. Cir 2001) (citing *Tennessee Gas Pipeline Co. v. FERC*, 969 F.2d 1141, 1144 (D.C. Cir. 1992) in turn quoting *New Jersey v. EPA*, 626 F.3d 1038, 1045 (D.C. Cir. 1980)). As the D.C. Circuit has emphasized, the "good cause" exception "is not an 'escape clause'; its use 'should be limited to emergency situations.'" *United Solid Waste*, 236 F.3d at 754 (quoting *American Fed'n of Gov't Employees v. Block*, 655 F.2d 1155, 1156 (D.C. Cir. 1981)(emphasis added)).⁸ And the D.C. Circuit has struck down interim rules where the good cause exception was not met. *See, e.g., Council of the Southern Mountains, Inc. v. Donovan*, 653 F.2d 573, 582 (D.C. Cir. 1981) (holding that the "limited nature of the rule cannot itself justify a failure to follow notice and comment procedures").

The FCC could not satisfy the "good cause" showing in this case. Consistent with the D.C. Circuit precedent, the Commission has utilized the "good cause" exception only in limited circumstances, including: (1) elimination of obsolete rules;⁹ (2) minor or technical changes;¹⁰ (3)

⁷ The cases cited by the competitors for the proposition that the FCC is afforded great deference in adopting interim rules do not permit the FCC to ignore the APA. To the contrary, in the cited cases, the interim relief was adopted *after* notice and comment. *CompTel v. FCC*, 117 F.3d 1068 (D.C. Cir. 1997) (challenging provisions of the 1996 Local Competition Order); *MCI Telecommunications Corp v. FCC*, 750, F.2d 135, 138 (D.C. Cir. 1984) (noting that the FCC orders were adopted "[a]fter .. public comment").

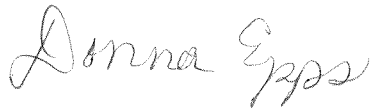
⁸ The good cause exception can be invoked only when an agency demonstrates that the notice and comment period would be "impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. § 553(b)(3)(B). The D.C. Circuit has found that a situation is impracticable "when an agency finds that due and timely execution of its functions would be impeded by the notice otherwise required in § 553." *United Solid Waste*, 236 F.3d at 754. The "unnecessary" prong is "confined to those situations in which the administrative rule is a routine determination, insignificant in nature and impact, and inconsequential to the industry and to the public." *Id.* Likewise, the court explained that "unnecessary" refers to the "issuance of a minor rule in which the public is not particularly interested." *Id.* For the public interest prong, the D.C. Circuit has found good cause when "the interest of the public would be defeated by any requirement of advance notice." *Id.* None of these circumstances exists here.

⁹ *See Schools and Libraries Universal Service Support Mechanism*, 18 FCC Rcd 9202, ¶ 90 (2003).

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procedural actions;¹¹ (4) incorporation of a Congressional dictate;¹² or (4) where interim rules are necessary to avoid regulatory confusion.¹³ No such factors apply here; to the contrary, imposing the measures sought by the competitors would dramatically alter the status quo and would manifestly violate the public interest.

Respectfully submitted,



cc: Lauren Belvin
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¹⁰ See *Amendment of the Maritime Services Rules to Implement Changes in the Coast Guard's Rules Pertaining to the Vessel Bridge-to-Bridge Radiotelephone Act*, 7 FCC Rcd 8552, ¶ 5 (1992).

¹¹ See *Amendment of Part 90 of the Commission's Rules to Facilitate Future Development of SMR Systems in the 800 MHz Frequency Band; Implementation of Sections 3(n) and 322 of the Communications Act - Regulatory Treatment of Mobile Services; Implementation of Section 309(j) of the Communications Act - Competitive Bidding*, 61 FR 6138, ¶¶ 416-417 (1995).

¹² See *Amendment of the Commission's Rules to Conform the Maritime Service Rules to the Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd 17069, ¶ 6 (1996).

¹³ See *Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 33 CR 861, ¶¶ 27-28 (Aug. 30, 2004); *Satellite Delivery of Network Signals to Unserved Households for Purposes of the Satellite Home Viewer Act; Part 73 Definition and Measurement of Signals of Grade B Intensity*, 14 FCC Rcd 2654, ¶ 98 (1999).